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An Introduction To Franchising In Alberta For Franchisors

Alberta
CONSUMER AND
CORPORATE AFFAIRS
Securities Commission

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PURPOSE OF THIS BOOKLET

The purpose of this booklet is to provide some general information on franchise legislation in the Province of Alberta and the filing requirements and procedures of the Alberta Securities Commission Agency, (referred to in this booklet as the "Agency") which administers the Alberta Franchises Act.

It is not intended to be a comprehensive text on franchise law; such texts are available in many public libraries. Nor is it intended to be a substitute for the kind of detailed professional advice you will need from lawyers, accountants, and others on particular aspects relating to your franchise application. This booklet answers general questions commonly asked by franchisors interested in franchising in Alberta.

THE FRANCHISES ACT

The Franchises Act regulates the trading in franchises in the Province of Alberta. The legislation requires a franchisor to register with the Agency and to provide a prospective franchisee with the information required to make an informed investment decision. The Act applies to persons and companies trading (selling) franchises or doing anything in furtherance of a trade.

What is a franchise?

In general terms, a franchise is defined as an agreement between two or more persons, by which a franchisee is required to pay, directly or indirectly, a franchise fee as defined in section 1(1)(h) of the Act in consideration for any of five rights listed in section 1(1)(f) of the Act.

Franchise Rights

The first requirement of a franchise is the granting of one or more of the following five rights:

Directed by Franchisor

The right to engage in a business of selling goods manufactured, processed, or distributed, or the services organized and directed by the franchisor.

Market Plan

The right to engage in a business of selling or distributing any goods or services under a marketing plan or system prescribed or controlled by the franchisor.

Trade Name

The right to engage in a business which is associated with the franchisor's trademark, service mark, trade name, logo, advertising or

any business symbol designated by the franchisor or its associate.

Reliant on Franchisor

The right to engage in a business in which the franchisee is reliant on the franchisor for the continued supply of goods and services.

Recruit Others

The right to engage in a business in which the franchisee has the right to recruit additional franchisees.

Contracts or arrangements between manufacturers, or if the franchisor is the Crown, Crown agency or a municipal corporation, are excluded from the definition of a franchise.

Franchise Fee

The second requirement is that a franchise fee be paid for the granting of one or more of the above franchise rights.

A franchise fee includes any consideration exchanged or agreed to be exchanged directly or indirectly for the granting of the franchise. Examples of direct franchise fees are the initial fees and ongoing royalties charged by a franchisor. An indirect franchise fee would exist in circumstances where the franchisee is required to purchase goods or services at prices above the current wholesale market rate.

Terminology and Language

The terminology or language used in an agreement may not necessarily have a bearing on whether or not the arrangement is a franchise, that is, the substance of the agreement as compared to the form of the agreement may be the determining factor as to whether an agreement is a franchise. Therefore, license agreements, distributor agreements, joint ventures, partnerships or any other type of arrangement which meets the criteria in sections 1(1)(f) and 1(1)(h) of the Act may be a franchise for purposes of the Franchises Act.

Registration

Section 6 of the Act requires the franchisor to file an application for registration and a franchise prospectus with the Agency and obtain a registration receipt before trading in franchises in the Province of Alberta. Therefore, a franchisor must be registered before promoting or advertising its franchise in Alberta. The franchise prospectus is a disclosure document containing all material facts relating to the franchise and must be accompanied by a certificate signed by the Chief Executive Officer, the Chief Financial Officer and two Directors of the franchisor.

The prospectus has three basic parts:

Disclosure Document

This document contains, among other things:

- a brief history of the franchisor and its directors,
- a summary of the obligations of the franchisee and franchisor, and its directors,
- a summary of the assistance provided by the franchisor.

Financial Statements

The franchisor's current audited financial statements must be attached to and form part of the prospectus. If the audited financial statements were prepared as at a date more than 120 days from the date of filing the prospectus, the franchisor must also attach to the prospectus unaudited interim financial statements prepared within 90 days of the date of the prospectus. In some circumstances the Director, Franchises of the Agency ("the Director") may waive the requirement to file unaudited interim financial statements, if there has been no material adverse change in the financial affairs of the franchisor and if the applicant agrees to a limited registration period of less than a year. The Director will normally establish a renewal date which will avoid the problem of stale dated financial statements in future years.

Franchise Agreement

A copy of the franchise agreement for use in the Province of Alberta must be attached to and form part of the prospectus. Any secondary agreements such as personal guarantees, sub-leases or registered trademark user agreements must also be attached to and form part of the prospectus.

Refer to page 7 of this booklet for additional details, on filing requirements.

Exemptions from Registration

Some franchisors may be exempted from the above registration requirements. The Act provides for certain statutory and discretionary relief from registration.

Statutory Exemption

Section 2 of the Act exempts franchisors from the registration requirements if:

- the franchisor has a net worth of more than \$5,000,000 and at least 25 franchisees, conducting business at all times during the 5 year period immediately preceeding the trade, or has conducted a business similar to that being franchised for at least five years, or
- the franchisor has a net worth of \$1,000,000 and is at least 80% owned by a corporation which meets the above requirements
- net worth in all cases is to be disclosed in audited financial statements.

Franchisors exempted from the prospectus requirements of section 6 of the Act must file with the Agency a Statement of Material Facts which is a

disclosure document requiring the answers to 25 specific questions regarding the franchise. Refer to section 5 of the Act for additional details.

No franchisor who claims an exemption under section 2 shall trade in a franchise until the franchisor has obtained an acknowledgement of the exemption under section 2 from the Director.

Discretionary Exemption

The Director may make an order pursuant to Section 3 of the Act exempting a trade in a franchise from the registration requirements, if he is satisfied that doing so would not be prejudicial to the public interest. The franchisor must demonstrate, to the satisfaction of the Director, that the prospective franchisee does not require a prospectus to assist in making the investment decision. This "need-to-know" principle will determine to what extent the Director provides relief from the registration requirements. When granting the exemption, the Director may impose conditions requiring the franchisor to provide a Statement of Material Facts or restricting the trades in some other manner.

Relevant factors in assessing section 3 applications for exemptions include:

- familiarity of the franchisee with the franchisor's operations (e.g. former long-term employee),
- the amount of the franchisee's investment in time and money, and
- past performance of the franchisor.

Franchisors should review Alberta Securities Commission Agency Policy 4-02, "Section 3 Applications", for a more complete discussion of the requirements in applying for a discretionary exemption.

Enforcement

Franchisors cannot trade in a franchise until registered with the Agency. Therefore, franchisors must refrain from advertising or soliciting until they finalize their registration. Registration is confirmed when the Registrar of the Agency issues a receipt for the prospectus.

Offences and Penalties

Any person who:

- makes a false or misleading statement in an application, prospectus, financial statement or other document filed under the Franchises Act,
- contravenes the Franchises Act or Regulations, or
- fails to comply with an order, ruling, direction or other requirement under the Franchises Act or Regulation,

is guilty of an offence and liable to:

- a maximum fine of \$2,000 or imprisonment of one year, or both, or
- in the case of a company, a maximum fine of \$25,000.

No person is guilty of making a false or misleading statement if he establishes that he did not know the statement was false or misleading and, in the exercise of reasonable diligence, would not have known that the statement was false or misleading.

REFERENCE MATERIALS

To assist you in preparing your application, the following materials accompany this brochure:

- The Franchises Act and Regulations
- Alberta Securities Commission Agency Policy 4-01 "Maintenance of Books and Records."
- Alberta Securities Commission Agency Policy 4-02 "Section 3 Application"
- Alberta Securities Commission Agency Policy 4-03 — "Form of Surety Bond Required Under the Franchises Act"
- Sample Franchise Prospectus
- Sample Statement of Material Facts
- Forms
 - Application for Registration - Form 1
 - Application for Registration as a Salesman - Form 5
 - Certificate of Intended Employer - Form 6

FILING PROCEDURES

Review of Applications

Agency staff review applications for registration, or exemption from registration, and issue their comments usually within 10 business days of receiving the applications.

The review of the application for registration has two primary purposes:

- to ensure that the prospectus complies with legislative requirements for full, true, and plain disclosure, and
- to identify those situations where it is not in the public interest to grant registration. The two most common concerns in this regard are the franchisor's financial position and business experience.

Full, True and Plain Disclosure

If the disclosure appears to the staff of the Agency to be incomplete, inconsistent or unclear, the franchisor must either revise the prospectus or provide acceptable clarification.

Financial and Operational Responsibility

A franchisor must demonstrate sufficient financial resources and business experience to provide the goods and services outlined in the prospectus. The Director will not register a franchisor if it appears that the financial position or business experience of the franchisor is inadequate in relation to the goods and services described in the prospectus. Franchisors unable to demonstrate financial or operational responsibility may be able to resolve such concerns by doing one or more of the following:

- Obtaining additional capital by way of either share capital or a subordinated loan.
- Placing the initial franchise fee in trust. Release of the funds from trust is subject to the consent of the Director. The Director will consent to the release of the funds when the franchisor has demonstrated to the satisfaction of the Director that it has provided the franchisee with the initial goods and services as set out in the franchise agreement.
- Obtaining an unconditional guarantee of the franchisor's obligations from a parent or affiliate of the franchisor. The guarantee shall form part of the franchise agreement. In addition, the guarantor must sign the prospectus and attach its audited financial statements to the prospectus.
- Registering an affiliated company which can better demonstrate an ability to fulfill the obligations to the franchisees. (e.g. registering a parent company instead of a subsidiary).
- Operating company owned stores in order to develop an operating history.

Whether any one or a combination of the above will resolve concerns about financial or operational responsibility depends on the circumstances of a particular application. The staff of the Agency does not, however, consider placing franchise fees in trust or providing a guarantee to be an acceptable solution in cases which the franchisors have only nominal share capital or lack business experience.

Responding to Staff Comments

The Agency staff will review applications and provide the franchisor with written comments within approximately 10 business days of receiving the application. Franchisors are required to provide written responses to the staff's comments.

When all comments and concerns have been resolved, the franchisor will be

asked to file a revised prospectus. The prospectus shall be manually signed as of a current date. Photocopied signatures are not acceptable.

The relevant financial statements and franchise agreements should be bound into the final prospectus. The required consent letters which make reference to the date of the final prospectus must accompany the final prospectus. The financial statements and consent letters shall be manually signed. Photocopied signatures are not acceptable.

Confirmation of Registration or Exemption from Registration

Registration or exemption from registration is acknowledged by the Agency issuing:

- a formal receipt for section 6 registration,
- an acknowledgment of the franchisor's section 2 statutory exemption, or
- an order pursuant to section 3.

The Director determines the period, normally one year, of registration or exemption from registration.

FILING REQUIREMENTS

Application for Registration

The following material is required to be filed with an application for registration pursuant to section 6 of the Act:

Franchise Prospectus

A prospectus shall provide full, plain and true disclosure of all material facts relating to the franchise being offered. The prospectus shall comply as to form and content with the requirements of the Act and Regulations. (A sample prospectus accompanies this booklet.) The prospectus must be manually signed and dated as of a current date. Photocopied signatures are not acceptable.

Franchise Agreement

A copy of the franchise agreement for use in Alberta and any secondary agreement must be bound into the prospectus.

Financial Statements

The prospectus shall contain the franchisor's financial statements. The financial statements shall be:

- bound into the prospectus and referenced in the body of the prospectus (refer to item 11 of the sample prospectus),

- prepared in accordance with generally accepted accounting principles,
- audited by an independent Chartered Accountant,
- prepared as of a date within 120 days of the date of the filing of the prospectus,
- accompanied by unaudited interim financial statements if the audited financial statement were not prepared as of a date within a 120 days of the filing of the prospectus. The unaudited financial statements must be reviewed by the company's auditor in accordance with section 7100 of the Canadian Institute of Chartered Accountants Handbook and be accompanied by a comfort letter signed by the auditor.

On application, the Director may waive the requirement to file unaudited statements if there has been no material adverse change in the financial affairs of the franchisor and the franchisor agrees to a short registration period.

Form 1

Application for registration.

Filing Fee of \$500

Fee to be made payable to the Provincial Treasurer.

Consent letter(s)

Auditor's

- in accordance with section 7100 of the Canadian Institute of Chartered Accountants Handbook.

Others

- as required by section 10 of the Franchises Act.

Board of Directors Resolution

A certified copy of the Resolution of the Board of Directors authorizing the filing and signing of the financial statements and the prospectus.

Application for Registration of Salesmen

At least one salesman must be registered to sell the franchise in Alberta.

Forms 5 & 6 must be filed by all trading representatives. Please ensure the required references accompany the application.

Filing fee of \$300 for each salesman. Fee to be made payable to the Provincial Treasurer.

Directors of the Franchisor

Each Director must file a Form 5.

Directors who are not salesmen need not provide reference letters.

Cross reference sheet

A sheet showing the location in the prospectus of the information required to be included by the form. Reference shall be made on the sheet of those items which are inapplicable or have negative answers and have been omitted from the prospectus.

Extra-Provincial Registration

Corporations not incorporated in Alberta must provide a copy of the certificate of extra-provincial registration.

Surety Bond

A surety bond (in the format set out in Alberta Securities Commission Agency Policy 4-03) will be required in an amount to be determined by the Director if the franchisor does not have any assets in Alberta.

Operations Manual

Franchisors should submit one copy of their Operations Manual for confidential review by Agency staff. This review is to ensure that the prospectus adequately describes the extent to which the franchise system has been developed. These manuals will be returned to the franchisor after the staff's review.

Application for Renewal of Registration

The following material is required to be filed with an application for renewal of registration pursuant to Section 6 and 19 of the Act:

Franchise Prospectus

The prospectus must be manually signed and dated as of a current date. Photocopied signatures are not acceptable.

Franchise Agreement

A copy of the franchise agreement for use in Alberta and any secondary agreement must be bound into the prospectus.

Financial Statements

The prospectus shall contain the franchisor's financial statements. The financial statements shall be:

- bound into the prospectus and referenced in the body of the prospectus,
- prepared in accordance with generally accepted accounting principles,
- audited by an independent Chartered Accountant,
- prepared as of a date within 120 days of the date of the filing of the prospectus,
- accompanied by unaudited interim financial statements if the audited financial statement were not prepared as of a date within 120 days of the filing of the prospectus. The unaudited financial statements must be reviewed by the company's auditor in accordance with section 7100 of the Canadian Institute of Chartered Accountants Handbook and be accompanied by a comfort letter signed by the auditor.

On application, the Director may waive the requirement to file unaudited statements if there has been no material adverse change in the financial affairs of the franchisor and the franchisor agrees to a short registration period.

Form 2 Application for Renewal of Registration

One fully signed copy.

Filing fee of \$500

Fee to be made payable to the Provincial Treasurer.

Consent Letter(s)

Auditor's

- in accordance with section 7100 of the Canadian Institute of Chartered Accountants Handbook.

Others

- as required by section 10 of the Franchises Act.

Board of Directors Resolution

A certified copy of the resolution of the Board of Directors authorizing the filing and signing of the financial statements and the prospectus.

Application for Renewal of Registration of Salesmen

Form 7 must be filed for each salesman.

A filing fee of \$300 made payable to the Provincial Treasurer for each salesman.

Cross Reference Sheet

A sheet showing the location in the prospectus of the information required to be included by the form. Reference shall be made on the sheet of those items which are inapplicable or have negative answers and have been omitted from the prospectus.

Red-lined Prospectus

To assist in the processing of a renewal application an extra copy of the complete prospectus may be filed. This extra copy is marked to show the sections which have been added to the preceding prospectus including agreements and marked to show deletions, additions and other changes from the preceding prospectus.

Application for Statutory Exemption

The following material is required to be filed to obtain an acknowledgment for a section 2 statutory exemption:

Statement of Material Facts

A Statement of Material Facts containing the information requested in section 5 of the Act and prepared in the format of the accompanying sample.

Eligibility Opinion

An opinion from the auditors or senior officers of the franchisor confirming the eligibility of the franchisor under section 2(b) of the Act.

Financial Statements

Audited financial statements as of a current date.

Board of Directors Resolution

A certified copy of the Board of Directors resolution authorizing the filing and signing of the Statement of Material Facts and the financial statements.

Filing Fee of \$300

Fee to be made payable to the Provincial Treasurer.

NOTE: Registration of a salesman is not a requirement with a section 2 exemption.

Application for a Discretionary Exemption

The material accompanying a section 3 application must be in the format prescribed by Alberta Securities Commission Agency Policy 4-02. In general terms, an applicant is required to file the following:

Covering Letter

- setting out the exemption requested and the reason for the exemption,
- providing information about the franchisor, such as name, history of the business,
- describing all criminal convictions, civil actions, and bankruptcy or receivership proceedings, if any, which the franchisor has been involved or, if none, containing a statement to that effect.

Franchise Agreement

Copy of the franchise agreement the two parties propose to enter into.

Affidavit from the Franchisee

Demonstrating

- historic business association with the franchisor,
- knowledge of the particular franchise and franchisor, and
- any other basis for requesting the exemption.

Describing

- previous experience with offerings of this type
- the advice received on this investment from a lawyer, chartered accountant, or others.

Filing Fee of \$300

Fee to be made payable to the Provincial Treasurer.

Statement of Material Facts

- where appropriate.

American Franchisors

American franchisors applying for registration pursuant to section 6 of the Act are required to file a prospectus. We suggest that the disclosures contained in the Uniform Franchise Offering Circular prepared pursuant to the North American Securities Administration requirements and guidelines form the foundation for an Alberta prospectus. At a minimum the following revisions are required:

Attach a face page as required by section 8 of the Regulations identifying the document as a prospectus.

Disclose Alberta statutory rights of withdrawal and rescission.

Disclose which country's currency is applicable and the exchange rate as of the date of the prospectus.

Provide disclosure and warning regarding books and records (See Alberta Securities Commission Agency Policy 4-01.)

State in the franchise agreement that Alberta Law shall govern the business arrangement and that jurisdiction for its enforcement is through Alberta courts.

Add any additional information determined by the franchisor and its legal advisors to render the disclosure full, true and plain.

Attach manually signed certificate of full, true and plain disclosure in accordance with section 9 of the Act. Photocopies are not acceptable. This certificate must appear at the end of the prospectus.

American franchisors must file all other material described in the Filing Requirement section of this booklet.

American franchisors filing for an exemption pursuant to section 2 of the Act are required to file a Statement of Material Facts. Where the franchisor has a Uniform Franchise Offering Circular (UFOC) it may be used as a foundation of the Statement of Material Facts. A face page, Alberta statutory rights, the currency applicable, and a certificate are required. The certificate for a statement of material fact verifies that the disclosure made is true.

The financial statements which form part of the UFOC must be manually signed and there must be obtained a consent letter from the auditors in accordance with section 7100 of the Canadian Institute of Chartered Accountants.

Incomplete Applications

Applications are initially reviewed by the Registrar of the Agency to determine whether or not they are substantially complete. Applications which are:

- unsigned,
- not accompanied by required audited financial statements, or
- not accompanied by the required filing fee

will be returned to the franchisor. The franchisor may re-submit the application when it is complete.

OTHER ASSISTANCE AVAILABLE FROM THE ALBERTA SECURITIES COMMISSION AGENCY

Agency Staff

Agency staff will respond to enquiries of a general nature regarding a particular aspect of the legislation, but the staff does not provide legal opinions as to whether or not a particular arrangement is a franchise.

Agency Library

The Agency library in Edmonton has a variety of reference materials available for review.

Franchise Prospectus

Franchise prospectuses and statements of material facts filed with the Agency are available for reviewing in the Agency's Edmonton offices for a fee of \$6 per file. Copies of a prospectus may be purchased for a fee of \$2 per page.

Agency Mailing Address

Applications and enquiries should be addressed to:

Alberta Securities Commission Agency
Franchise Section
21st Floor, 10025 Jasper Avenue
Edmonton, Alberta
Canada
T5J 3Z5

Attention: Director, Franchises

Telephone (403) 427-5201

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